

GASB Questions for Video Conference
November 17, 2005

1. It is our understanding that, although GASB is not mandating that states ‘advance fund’ OPEB, state governments are beginning to look for ways to finance their obligation.
 - a. What disadvantages do state governments face if they do not ‘advance fund’ their obligation?
The pay-as-you-go funding method is the most expensive alternative as asset earnings cannot be used to offset the benefit obligations. It also results in future tax payers assuming current cost obligations and could be characterized as “management by train wreck”. Rating agencies will look at the OPEB liability and see how it is being managed. Options to deal with OPEB liability are somewhat limited and include management of the growth of the liability; increase in the assets; or a change in the cost sharing arrangement with participants.
 - b. Can a state ‘advance fund’ its obligation by applying the retiree portion of its current trust fund reserves?
GASB does not restrict the sources of funding. Assets can be put into a qualified trust to advance fund the obligation. If the funds are already in a trust then they need to be segregated between actives and retirees. There are no requirements on how that should be done.
2. Several news articles were written about state governments issuing bonds to ‘advance fund’ their obligations.
 - a. What types of bonds are these?
OPEB bonds are like pension obligation bonds.
 - b. When is it appropriate to issue bonds?
Decisions to fund the OPEB liability by issuing bonds is not the most fundamental issue for GASB. However, if consideration is being given to the use of bonds, at minimum, a comparison of the interest rate of the bonds versus the plan’s rate of earnings is required. Issuance of bonds results in bonded debt that is a hard liability and must be reflected on the financial statements.
3. In a report from Mercer Human Resource Consultants at the National Conference of State Legislatures, Mercer recommended a rule of thumb of multiplying current annual cash cost by 50 to estimate the unfunded liability.
 - a. Is that ‘rule of thumb’ reasonable, too conservative, or not conservative enough?
The ‘rule of thumb’ is drawn from limited cases and the actual unfunded liability will be impacted by factors such as the maturity of the group, the ratio of actives to retirees etc. The ‘rule of thumb’ was taken from a Sacramento, California article which had estimated the unfunded liability at \$40 billion.
4. Because of the high cost of health care benefits, governments using the ‘pay as you go’ (PAYG) funding method can expect to incur a significant unfunded liability on their financial reports once OPEB is reported.
 - a. What percentage of governments use the ‘PAYG’ funding method as opposed to the ‘advance funding’ method?

The 'PAYG' funding method probably represents 95% of governments. Most governments don't budget for OPEB and so it has been easier to grant increased retiree benefits than a pay increase. The increase in retiree benefits costs a lot more to fund.

- b. Because so many governments are in the same position, won't the bond companies factor that in before rating the governments?
Rating agencies such as S&P, Moody's, and Fitch will look at the OPEB funding liability. However, because so many entities will be in the same position and the amounts will be large for everyone, there may not be immediate judgments by the rating agencies initially. Rating agencies will likely focus on the plan of management.
 - c. If governments refuse to comply with GASB 43 or 45 or miss the filing deadlines, what is the impact?
5. To prevent possible bankruptcy and enormous unfunded liabilities, some governments are reducing or considering reducing their health insurance benefits.
- a. If benefits are reduced for new employees or there is an increase in the number of years needed to vest, how will that impact the actuarial valuation calculation?
Changes are more likely to be done on a prospective basis for a number of reasons. New participants will be affected and the liability reduced over time.
6. Governments are still in the early stages of addressing the requirements of GASB statements 43 and 45.
- a. What progress have other governments made to date?
There is a wide range of scenarios with some states like Massachusetts who have passed legislation to deal with the GASB 43/45 issues and other states that are only recently becoming aware of the issues. Some have determined for informational purposes what kind of benefits apply and how to account for them, but have not implemented the GASB standards. Bottom line, there is a lot of preparation that is required and states should not wait.

Post-Session Discussion

1. Next Steps involve a three-prong approach
 - a. Education
 - b. Complete the Definition of the Plan
 - c. Undertake the Valuation which will include development of the RFP
The RFP may encompass two parts: Valuation and Services to determine funding approaches/alternatives.
AG's Office is assisting in reviewing sample RFPs.
2. Seeking AG opinion on the status of the plan as a qualified trust or equivalent. Hope to know before late December.
3. Counties need to know what kind of data must be provided, if any, as soon as possible.